

# Review on Status of Micro and Small Enterprise (MSE) Development in Ethiopia

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## Abstract

In most of developing countries, agriculture failed to feed and sustain rural population due to high rate of population growth, poor technology, lack of capital accumulation, and unfavorable climatic condition. Around 85% of Ethiopia's population depends on smallholder agriculture, mostly in subsistence farming. The current Ethiopian government has been implementing ADLI policy that favors industry sector. To realize this, Ethiopian government paid attention to MSEs development where they taken as a benchmark for propelling industry sector. Taking in to account the role of micro and small enterprise in economic development, the review was aimed at exploring the status of MSEs in Ethiopia. The review showed that, the number of MSEs establishment has been increasing over last years. In terms of employment creation, the number of employees absorbed by MSEs has shown increasing trend over years. In terms of capital formation and contribution to country's GDP, rate of capital in MSEs is below 50% and contribution of industry sector is very low suggesting use of various policy option to make them strong in terms of capital formation so that they contribute to national GDP significantly.

**Keywords:** Micro and Small Enterprises, Employment creation, Capital formation, GDP

## 1. INTRODUCTION

Recently, urbanization expanding more rapidly and has become a development agenda for both developed and developing country (Tendayi *et al.*, 2009). For instance, in Ethiopia, EEA (2009) indicated 4% growth rate of urbanization which exceeds national population growth rate nearly 1.5% indicating high rural urban migrations. In most of developing countries, agriculture failed to feed and sustain rural population due to high rate of population growth, poor technology, lack of capital accumulation, and unfavorable climatic condition. Around 85% of Ethiopia's population depends on small-holder agriculture, mostly in subsistence farming. Rural population growth is leading to a decreasing average size of holdings resulting in an increasing number of households for which subsistence farming is no longer a viable way of life. In addition, thousands of students graduating from universities and colleges have aspirations of not returning to their parents' farms, but instead moving into urban and peri-urban areas, to look for jobs. Between 2 and 2.5 million young people are entering the labor market every year (WB, 2012). Therefore, Ethiopia needs to urgently address the needs of a rapidly increasing job-seeking population through different policy alternatives.

One of the alternatives put forward by Ethiopian government to deal with rising labor force is development of small and microenterprise. Micro and small enterprises contribute to the reduction of poverty and vulnerability of the poor through enabling them to break the vicious cycle of poverty, and to enhance self-empowerment, respect and social dignity. They allow poor people to increase their income and accumulate assets. Ethiopia's Growth and Transformation Plan seeks to transform the economy from a predominantly agrarian to a modern and industrialized economy. The current plan (Growth and Transformation Plan (GTP) 2010/11–2014/15) provides the medium-term strategic framework that guides the country's efforts towards accelerating GDP growth and employment creation. The GTP seeks to transform Ethiopia to an industrialized economy and increase the per capita income of its citizens to middle-income levels by 2025. The Ethiopian Government is preparing a second GTP five-year program and a ten-year perspective plan, both of which place high emphasis on manufacturing development (World Bank, 2015). A plan highly focuses on growth of private manufacturing industry.

Taking in to consideration the role of small and micro enterprise in economic development, Ethiopian governments' intension to transform small holder's agriculture in to industrial economy, this seminar paper has reviewed status of MSEs in Ethiopia evidenced by different literatures. The aim of this seminar paper is to review current status of micro and small enterprise development in Ethiopia with focus on performance and contribution of micro and small enterprises in Ethiopia and small and microenterprise business support service provided by Ethiopian government.

## 2. BODY OF DISCUSSION

### 2.1. Performance and its Measures

According to GME (2004), performance is the act of performing something successfully using knowledge as distinguished from merely possessing it. However, performance seems to be conceptualized, operationalized and measured in different ways thus making cross-comparison difficult. Performance measurement is a process for

collecting and reporting information regarding the performance of an individual, group or organizations. It can involve looking at process /strategies/ in place, as well as whether outcomes are in line with what was intended or should have been achieved.

Financial performance can be seen from two dimensions. One, it can be evaluated from financial dimension, and non financial dimension from the other. Financial performance measurement generally looks at firms' financial ratios or increase in profit. Non-financial performance measurement is more subjective and may look at customer service, employee satisfaction, perceived growth in market share, perceived change in cash flow, and sales growth (Haber and Reichel, 2005). Ababiya (2013) analyzed micro and micro enterprise performance using benefit cost ratio. The problem with the use of benefit and cost as a measure of performance in this case is, the difficulty that is faced in accounting appropriate benefit and cost figures for enterprises. Particularly in Ethiopia, peoples have a culture of over estimating the cost and under estimating the benefit leading a problem in capturing appropriate performance. In this case, one of the alternatives is to use income or cost ladder that have different income range and letting the enterprise respondent choose in which category they are during the period of analysis. The other option is, to prepare pro-forma containing all income and cost items of the enterprise and to calculate benefit and cost using market price.

Kamunge *et al.*, (2014) used different performance indicators like increase in sales, business expansion, customer retention, and increase in stock, waste reduction, and cost reduction in their study of factors affecting the performance of small and microenterprise while Mashimba and Kuhl (2014) analyzed business performance in terms of enterprise revenue and enterprise capital investment in machinery as measure of performance. Moreover, Abera (2012) used profitability as a measure of performance in his analysis of factors affecting the performance of micro and small enterprises in Areda and Lideta sub cities of Addis Ababa. Generally, most studies measure business performance from financial dimension. This review focuses on capital formation, contribution to GDP, and employment creation as a measure of MSEs performance.

## 2.2. Performance and Contribution of Micro and Small Enterprise

It has been recognized over the world that one of the mechanisms to reduce poverty is a focus on the development of MSEs, which generate income and employment opportunities (MUDC, 2013). It is well known fact that microenterprises generally account for bulk of the total enterprise population, irrespective of the level of development of a country. In many countries of the world, particularly those in Africa and Asia, the micro enterprise sector constitutes the majority of the working population. Micro and small enterprises play various roles in economic development of a nation that include building up local production structure, creating employment opportunity and achieving a fairer distribution of national resource, income, knowledge and power, help to promote rural industrialization, and promote export market (Mulugeta, 2008).

A study by Tadesse (2010) on the role of micro and small Enterprises in employment creation and income generation has showed importance of micro and small enterprise. In his analyses, he found that, as there are difference between previous annual average income per individual (before starting this business) and annual average income after they have joined MSEs. Accordingly, MSE owners who have previous occupation were getting annual average income of 4,387 birr. The income situation of micro and small enterprise owners after they have joined the enterprise by sectors was, the construction sector has an annual average income of 4,948 birr, the service sector has an annual average of 4,983 birr and the industry sector has annual average of 3,234 birr indicating the role of MSEs in income generation.

According to the same source, MSEs created employment opportunities for those owners of MSEs, and among those owners of MSEs 23.7 percent had been unemployed, this means that MSEs created job to 23.7 percent of the employed people. In addition to this, MSEs created employment for 17.9 percent of students in high school, college and university. From this we can conclude that MSEs have indispensable role in employment creation. Those employed in MSEs also gain direct and indirect positive effect by being employee of MSEs.

In Ethiopia, the number of MSEs establishment and employment creation has shown increasing trend. The number of MSEs in 2010/2011, 2011/2012, 2012/2013, 2013/2014, and 2014/2015 were 51,983, 70,455, 77,415, 200,319, and 271,519 respectively. When we see the trend of employment creation, the number of employment created in 2011/2012, 2012/2013, 2013/14, and 2014/2015 were 806,322, 1,223,679, 2,500,000, and 2,800,000 respectively as shown in figure below.

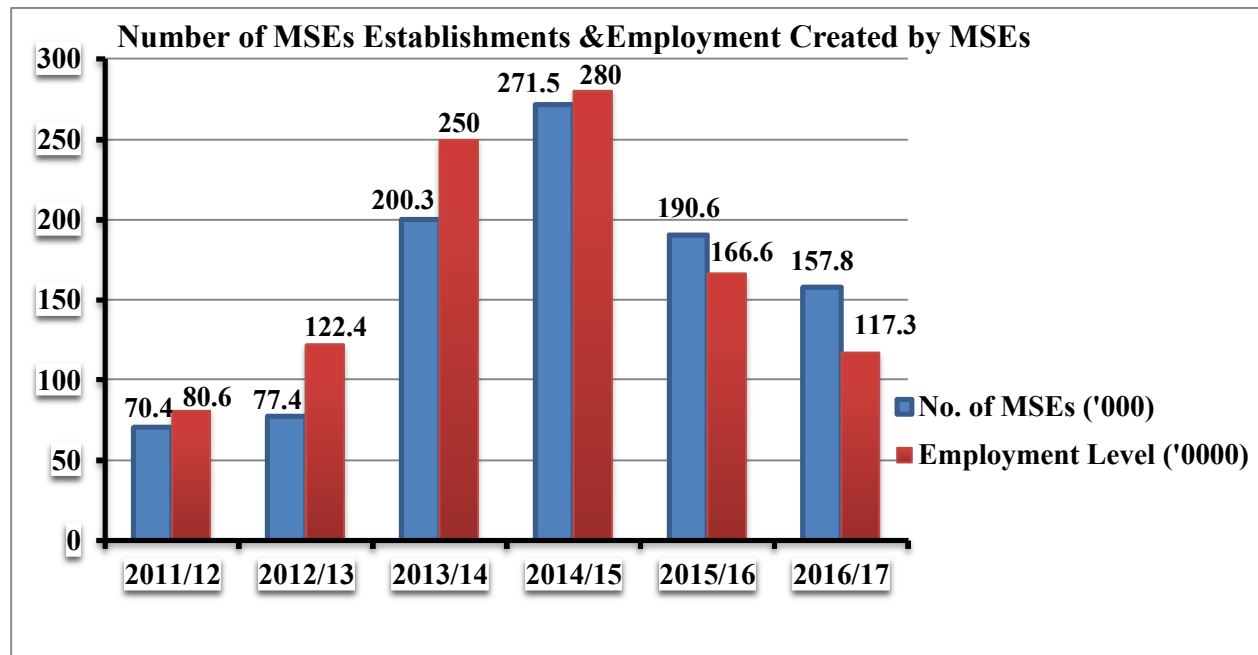


Figure 1: Number of MSEs Establishments and Employment created by MSEs

Source: Authors' sketch based on NBE annual report from 2011/12 – 2016/17

In terms of contribution to national GDP, construction sector contributed 2.2 percentage points to GDP growth and accounted for 81% of the total growth contribution of the industry sector. At the same time the manufacturing share in GDP is rather stable at or just above 4.1% of GDP. The manufacturing sector has grown at an average of 10.9 percent in last decade about the same rate of expansion as real GDP thereby falling short of the targeted 22% in the GTP. The share of manufacturing MSEs in GDP has declined from about 1.6% in 2004/05 to 1.3% in 2012/13. Despite the significance of their number in the economy, their share in GDP is lower than the share of large and medium scale manufacturing industries throughout the period. The share of employment in the manufacturing sector has changed only slightly and is virtually unchanged between 4.4% and 4.7% of total employment between 1999 and 2013 (EEA, 2015).

Contribution by enterprise size indicated that, small firms had the highest employment growth rate of 14.4%, while medium and large firms experienced growth rate of 9.5 and 2% respectively. Firms in services had slightly higher employment growth (12%) compared to firms in manufacturing (10%). In terms of job creation, medium-sized firms generated 45% of the total of new jobs, while small firms generated almost as many new jobs as large firms. However, large firms remain the main contributor to total employment (78% of total jobs in 2010) compared to medium firms which contributed 15% of total employment in the same period (WB, 2015).

Recently, the industry sector is the highest growing sector, driven by a construction boom and expansion in mining sub-sectors. The industrial sector growth rate was 18.5% in 2013/14. But manufacturing, which forms part of industry and is dominated by the food, beverages, leather, textiles, and apparel industries, contributed a meager 4.4% to GDP in 2014 and on average grew only by 11% during the same period. The manufacturing export sector is relatively small in terms of production and employment, constituting 10% of total export merchandise. Given that the manufacturing sector has grown at the same pace as the economy, its contribution to GDP has remained static (World Bank, 2015).

Good performing MSEs should graduate after a certain time based on the criteria set by authorized institution. Micro and Small Enterprises Development Agency (MSEDAs) have started graduating MSEs to medium enterprises since 2010. One of the criteria is in terms of total asset. Accordingly, MSEs in the manufacturing sector should have a total asset worth 1.5 million ETB while service providing MSEs are required to have 500,000 ETB worth of asset to qualify for graduation. Some of the other graduation criteria include; a certain degree of technical efficiency, track record of loan repayment and saving with the Micro Financial Institutions (MFIs) etc. A total of 619 MSEs have graduated in Addis Ababa, where 55.5% are MSEs engaged in the manufacturing sector particularly metal, wood and textile sub sectors (EDRI, 2014).

According to Jafri and Gebrechristos (2014), performance of enterprises is evaluated by assessing the share of the given enterprise on the basis of job creation and growth to the next higher level. In their survey with MSEs in Southern Nations, Nationalities and Peoples Region (SNNPR), they found that higher conversion (transition) rates were observed in construction (25.4%) and manufacturing (41%) both sectors accounting about 66.4 % of the total transfer from one level to the next higher level. Performance of urban agriculture was very little for both

job creations and growth level. According to a report by Ministry of Urban Development and Construction (2013), about 20% of the micro enterprise (i.e. greater proportion within the group), have registered a real capital growth of between 20-50%. However, for smaller enterprises it is those that registered a high capital growth of more than 100% that make up for the majority (22.5%) in the sub class. Regarding declining firms, the proportion from the smaller firms is about 12.2% while it is 8.1% from the micro ones. Despite the MSE sector is given attention by GoE, information on performance indicators (i.e. Numbers of MSEs transitioned to higher levels, contribution to national GDP, and capital growth) of MSEs at national level is limited.

### **2.3. MSE Development Support Policy of Ethiopia**

In order to achieve its goal of transition to industry, Ethiopia has extended different business support policy to enhance business performance and to create a conducive business environment for MSE growth. This policy support includes access to markets, access to finance, access to industrial extension, access to training and technological support. One of the major challenges that hampers the growth and development of MSEs in Ethiopia is access to sufficient and sustainable market. To solve this problem, the government is intervening in three ways. One, the government itself buys goods directly from MSEs. Second, the government tries to link MSEs with large and medium enterprises in the market in the form of subcontracting and input suppliers. Third, a number of bazaars and trade exhibition have been organized by MSEs development agencies to promote MSEs' products and to link them with large and medium enterprises and foreign buyers (EDRI, 2014).

The other area of MSEs promotion and support is provision of industry extension service. The national industry extension service is based on primary objectives of making MSEs competent enough in the market, enabling them to generate sufficient and sustainable job opportunities thereby improving their income. The industry extension service elements consist of entrepreneurship, business development services, production technique, marketing management, supplies management, book keeping and continuous productivity improvement or kaizen. These services are disseminated through in-company training and consultation and through group discussions of enterprises that are engaged in the same sector (ibid).

Skilled manpower and the use of appropriate technology are critical inputs to nurture micro and small enterprises. In this regard, the national MSE promotion and development strategy paid due attention to human resource and technological development. To develop business skills of entrepreneurs, government directly provides various skill trainings to potential entrepreneurs of the sector.

The other support by the government to promote MSEs is provision of financial support. To alleviate financial problems of MSEs, Federal Micro and Small Development Agency (FeMSEDA) has designed a national micro credit and saving directive of MSEs operating in the country. Financial needs of MSEs handled according to the priority areas of national MSEs policy. Accordingly, priority areas of the national micro credit system include those MSEs that are engaged in import substitution, construction and export. The level of initial saving depends up on the stage to which MSEs are in. Another MSE support area is working space. Location of MSEs determines accessibility to the market. In reaction to this, the government has built working spaces for MSEs in major cities and towns, but working space still remains a critical challenge. The supply of working spaces is small relative to demand. Many government agencies like FeMSEDA and Regional Micro and Small Enterprises Development Agency (ReMSEDA), MFIs, Land Development and Management Bureaus, and other infrastructure providers such as Ethiopian Electric Power Corporation (EEPC), Ethio-Telecom and Water and Sewerage Management Authority are involved in implementation of the MSE policy. Poor coordination among these agencies was found as problem during the implementation of MSEs policy. In order to solve policy coordination problems, Ethiopia instituted coordination councils both at Federal and Regional Levels (EDRI, 2014). Figure below shows amounts of loan offered to MSEs to over time.

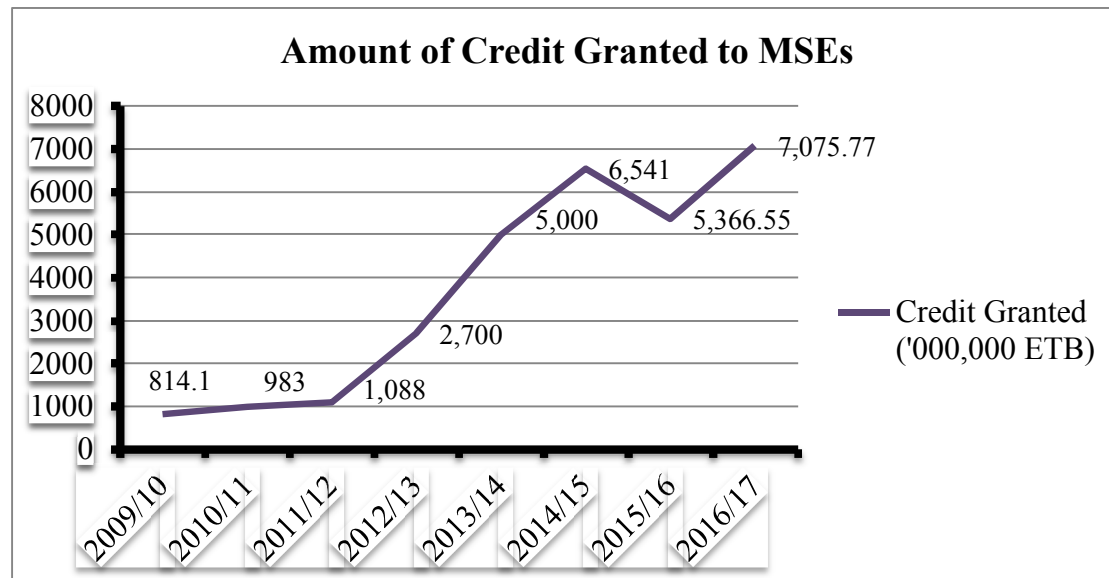


Figure 2: Amount of credit granted to MSEs

Source: Authors' sketch based on NBE annual report from 2011/12 – 2016/17

### 3. CONCLUSIONS

Recognition of the role of MSEs has led countries of the world to pay attention toward its development to influence macroeconomic variables. This review tried to incorporate MSEs contribution to economic growth, and performance of MSEs. The government of Ethiopia has been implementing Agricultural Development Led Industrialization (ADLI) policy that favors industry sector. To realize this, Ethiopian government paid attention to MSEs development where they taken as a benchmark for propelling industry sector. This review showed that the number of MSEs establishment has been increasing over last years. On top this, assessing their performance in terms of capital formation and graduation rate from time to time is very important to see their effect on national economy of a given country. In Ethiopia; in terms of employment creation, the number of employees absorbed by MSEs has shown increasing trend over years. In terms of capital formation and contribution to country's GDP, rate of capital in MSEs is below 50% and contribution of industry sector is very low suggesting use of various policy option to make them strong in terms of capital formation so that they contribute to national GDP significantly.

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